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C O N F I D E N T I A L SECTION 01 OF 03 SAO PAULO 000194

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TAGS: ECON EIND EFIN ELAB BR
SUBJECT: AUTO SECTOR COMMENTS ON STATUS AMID ECONOMIC
DOWNTURN

REF: A. BRASILIA 141
¶B. SAO PAULO 126

Classified By: Consul General Thomas White; Reasons 1.4 (b) and (d).

¶1. (C) SUMMARY: On March 6, Ambassador Sobel met separately with General Motors (GM) MERCOSUL President Jaime Ardila, and the Brazilian National Automobile Manufacturer's Association (ANFAVEA) President Jackson Schneider. Both executives are bullish about car sales in Brazil, crediting the Government of Brazil's (GOB) decision to lower production taxes on automobiles for the auto industry's initial recovery in 2009. However, slowing export markets due to protectionist reactions abroad, particularly in Argentina, are causing a relatively modest decline in sales from last year. This has even prompted some business leaders to advocate that Brazil abandon MERCOSUL. While the GOB has not announced whether its car tax suspension will be renewed at the end of March, manufacturers credit the measure with stimulating sales and believe it will be extended. END SUMMARY.

Auto Industry Beginning to Recover

¶2. (U) Jaime Ardila told Ambassador Sobel that Brazil was GM's most profitable market last year. Because of the financial crisis, however, GM expects its production in Brazil to decline from 12,500 automobiles per day in 2008 to 11,000 per day this year. Ardila remarked that the decline in Brazil was relatively small compared to the 34 percent sales drop in the United States. While GM made USD 1.5 billion in profit in Latin America (with most of that in Brazil) last year, Ardila expects that number to drop by approximately one-third in 2009.

¶3. (C) After production collapsed in December (production was 56 percent lower in December 2008 than the same month in 2007), Ardila and Schneider both credited the recent boom in sales to the GOB eliminating the industrial production tax (IPI) on small cars (below 1000 cc) and by 50 percent on larger cars (Ref A). Ardila estimated that this resulted in an effective reduction of seven to 10 percent of the total price of a new car. While the IPI tax is scheduled to return

on March 31, Ardila told Econoff that he expects the tax cut will be extended. (NOTE: The GOB announced on March 30 that it intends to extend the tax break for three months.) According to Ardila, the car industry cut a deal with the GOB to withhold announcements for an extension of the IPI tax cut until the end of March in order to spur auto sales through the end of the month. Separately, Schneider also informed the Ambassador that ANFAVEA is lobbying the GOB to extend the tax through July and will also push for an indefinite extension.

¶4. (U) Ardila also credited the recent up-tick in auto sales to improved credit conditions. He noted that auto loan maturities had returned to what he considers the more reasonable range of 42 to 60 months. In early 2008, the Central Bank was concerned that auto loan maturities were too long, sometimes exceeding 70 months, which meant that the loans effectively went beyond the depreciation value of the vehicle. When the financial crisis first hit Brazil in September, the banking industry moved quickly to reduce auto loan maturities, meaning consumers needed more cash on hand to purchase a vehicle. Ardila sees that situation now returning to normal, which should auger for supporting increased demand for new cars.

¶5. (SBU) Ford Brazil CEO Marcos de Oliveira presented a similar auto sector outlook in a March 17 conversation with the Consul General. After a difficult fourth quarter to close 2008, Ford sales in January and February 2009 are only two percent lower than the comparable period in 2008. The

IPI tax reduction has been key, as de Oliveira estimates that sales would have been down 30 percent without the measure. Like his GM counterpart, the Ford CEO indicated that the Lula government will extend the IPI tax reduction for an additional 90 days at the end of March. Domestic passenger auto sales in Brazil totaled 2.8 million vehicles in 2008. (Brazil produced 3.2 million, with the remainder going to the export market.) De Oliveira believes that Brazil could reach 2.6 - 2.7 million in domestic sales for 2009, but expects a 20 percent fall in 2009 exports.

Labor Issues and the Auto Industry

¶6. (SBU) Ardila told the Ambassador that the local press had inaccurately portrayed recent lay-offs at its plants in Brazil as firings. He explained that GM had simply opted not to renew the expiring contracts for some of their temporary employees. Ardila expressed concern about Embraer's legal woes after dismissing one-fifth of its workforce (Ref B), but was optimistic concerning GM's pending labor lawsuit being decided in Sao Jose dos Campos, because GM had not violated its labor contracts. Indeed, Ardila told the Ambassador that GM plans to hire back some of the workers, and, as a gesture of goodwill, GM would allow the union to claim victory.

MERCOSUL and Brazil's Auto Industry

¶7. (SBU) While GM has been successful with its passenger cars in the MERCOSUL region, the heavy truck industry has been hit hard, losing 20 percent of its market share, according to Jackson Schneider. Much of this reduction is due to a decrease in exports, which account for 20 percent of automobile production in Brazil. Schneider said publicly in centrist newspaper "O Estado de Sao Paulo" that exports over the last six months have fallen from 115,700 units to 59,200 units, a decline of 57 percent. He told the Ambassador that he blames the decline on shrinking international markets and increasing protectionism, citing Argentina and Venezuela specifically. Despite these setbacks, Schneider expects overall passenger car sales in Brazil to decline by only 3.5 percent in 2009.

¶8. (C) Ardila expressed similar concern for GM's Argentine operations, characterizing the Argentine economic situation as "a disaster waiting to happen." He told the Ambassador he believes the GOB is increasingly frustrated with Argentina's obstinacy against a bilateral trade deal, and thus sees an opportunity for the United States to improve its own bilateral relations with Brazil. Schneider believes that ANFAVEA benefits from MERCOSUL's tariff provisions, but confided that at a recent meeting at the Sao Paulo Federation of Industries (FIESP), top business leaders were privately advocating that Brazil leave the trade bloc.

Ardila Discusses Negotiations at GM Headquarters
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¶9. (SBU) Ardila told the Ambassador that Brazil's GM operations were used as collateral in GM's recent restructuring negotiations with the USG. Globally, GM needs an additional USD 5.5 billion to meet its USD 18 billion total financing needs to restructure. Ardila noted that if GM filed for Chapter 11 bankruptcy in the United States, the company would need some USD 100 billion. GM's two major global costs are labor and health care. Ardila said that Japanese manufacturers pay USD 45 per hour on average to their domestic autoworkers, while GM pays USD 65 per hour in the United States. Although this price discrepancy has narrowed in the last five years, it still makes small cars unprofitable and limits GM's market to larger vehicles. Health care payments, especially to retirees, remain the

single biggest global expense for GM.

¶10. (SBU) Ardila expressed optimism about GM's global future if auto sales continue to show some recovery. He noted, however, that GM's global sales averaged 9.5 million in January, and if sales did not pick up to an average of 10.5 million vehicles, its debt payments for 2011 could be problematic. Ardila believes GM will emerge as a much more efficient company if it survives the next two years, saying that even a small recovery would generate profits for a restructured GM. Ardila told the Ambassador that he believes GM is too big to fail, and cited the launch of the new electric car, the Volt, as one example of GM's bright future. (NOTE: GM does not plan to sell the Volt in Brazil. END NOTE.)

¶11. (C) COMMENT: Auto production is normally a leading indicator of the overall economy as it represents ten percent of Brazilian manufacturing. However using autos as an economic indicator this year is problematic as the tax break was limited to that sector. In fact, overall industrial production declined by 7.4 percent last quarter, suggesting that the financial crisis continues to affect the rest of Brazil's manufacturing base. Since the GOB has extended the IPI tax break through July as ANFAVEA hoped, auto sales are likely to continue to resist the crisis and stay strong, but without a similar stimulus package for other sectors, overall manufacturing may not improve. Last quarter's GDP declined by 3.6 percent over the previous quarter, which will have a negative carry-over effect on GDP for 2009. Given the real signs of a slowdown, President Lula is actively searching for ways to keep the economy strong, and with a recession looking increasingly likely, the GOB may consider implementing tax breaks similar to the IPI tax cut as a means of stimulating other manufacturing sectors and the overall economy. END COMMENT.

¶12. (U) This cable was coordinated with and cleared by Embassy Brasilia.
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